

US-REITs & S-REIT Investment

Manulife US REIT U.S. Tax Seminar
Manulife Tower

David H. Kaplan
dkaplan@sandw.com
+1 (617) 338-2856

SULLIVAN &
WORCESTER

Background

- US Congress passed REIT Act in 1960
 - > REITs typically don't pay corporate income taxes
 - > Allow investors access to commercial real estate
 - > Public and private REIT tax structures widely used
- 1984 Tax Reform Act passed portfolio interest exemption rules
 - > Portfolio interest paid exempted from US 30% withholding taxes
- 1986 Tax Reform Act reform expanded permissible REIT activities, including provision of services
- 1999 legislation created taxable REIT subsidiaries
- 2015 PATH Act simplified REIT requirements, particularly for global REITs, but tightened requirements around some non-real estate investment
- 2017 Tax reform – favorable to real estate, generally

Tax Advantage: REIT vs Corporation

Traditional C Corporation

Corporation Earns Return on Investment



Tax on Income of the C Corporation



Corporation Pays Dividend to Shareholders



Tax on Dividend to Shareholders

Tax-Advantaged REIT

REIT Earns Return on Investment



No Tax on Income of REIT*



REIT Pays Dividend to Shareholders



Tax on Dividend to Shareholders

*Assuming that all REIT taxable income is paid out as a dividend to REIT shareholders

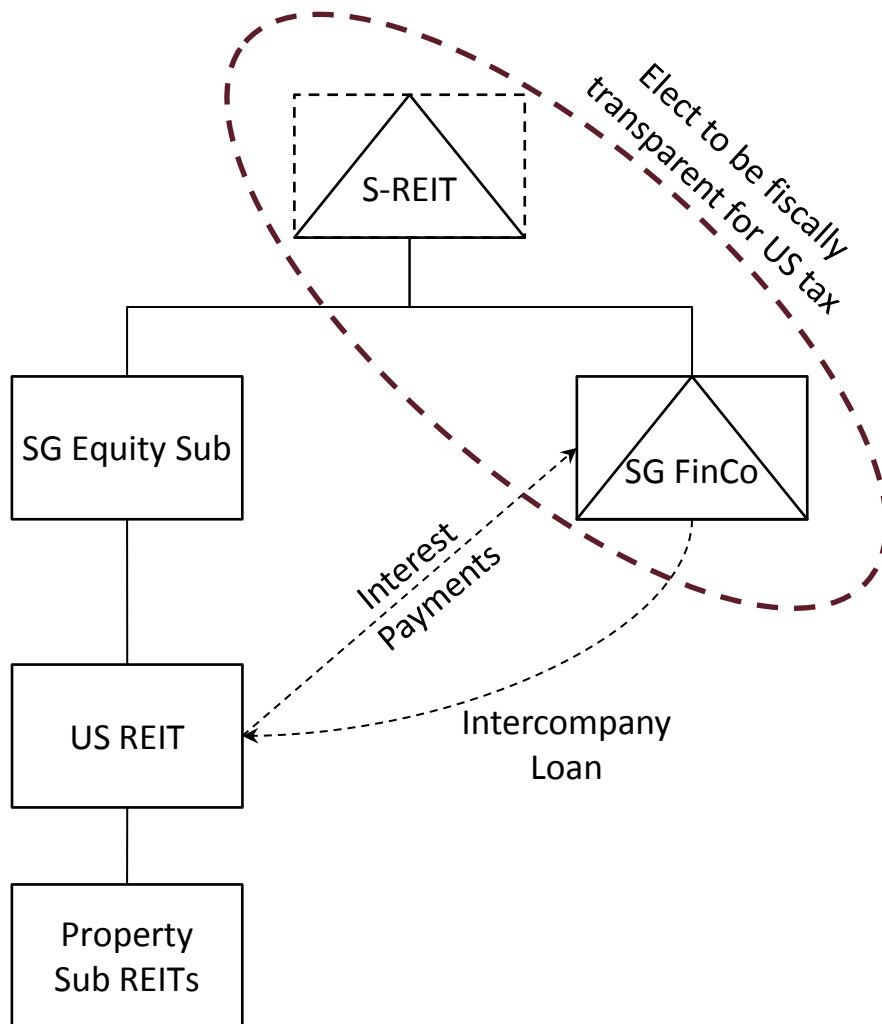
Why are REITs Utilized?

- As a regarded taxable entity, a REIT serves as a blocker for non-U.S. persons
 - A non-U.S. shareholder will generally not be treated as engaged in a U.S. trade or business solely as a result of its investment in a REIT
 - U.S. tax return filing requirements are generally minimized for non-U.S. persons
 - Dividends paid by REITs are generally subject to the U.S. withholding rules applicable to dividends paid by any U.S. corporation
 - Rate of withholding on dividends is generally 30%, but often reduced by treaty or by U.S. statute to as little as 15% or even 0%
- But the Foreign Investment in Real Property Tax Act (FIRPTA) is an exception to the above favorable rules
 - FIRPTA treats the gain or loss realized by a non-U.S. investor from the disposition of a U.S. real property interest as effectively connected to a U.S. trade or business
 - FIRPTA generally applies to any dividend by a REIT attributable to the REIT's gain from the disposition of a U.S. real property interest

Qualification as a US REIT

- To maintain REIT status, various requirements (**ORIAD**) must be met:
 - > **O**rganization & Capital Structure
 - > **R**evueue from Real Property
 - > **I**ncome from Other Sources
 - > **A**ssets
 - > **D**istributions of Income

Case Study: MUST Original US REIT Structure



- US REIT Income:
 - Not taxed if distributed
- Interest:
 - U.S. withholding: **Portfolio interest exemption**
 - Not subject to taxation in Singapore
- Dividends:
 - U.S. withholding on distributed earnings
 - Not subject to taxation in Singapore
- Original MUST and KORE structure

2017 U.S. Tax Legislation

- Limitations on deduction of interest
 - > Section 163(j)*
 - > Section 267A
- Section 163(j) limits business interest deductions to 30% of adjusted taxable income
 - > There is an exception to this limitation for an “electing real property trade or business”
- Section 267A denies the payor of interest a deduction for any “disqualified related party amount” paid or accrued pursuant to a “hybrid transaction” or by, or to, a “hybrid entity”

*All Section references are to the U.S. Internal Revenue Code, as amended.

Case Study: MUST Existing Tax Structure¹

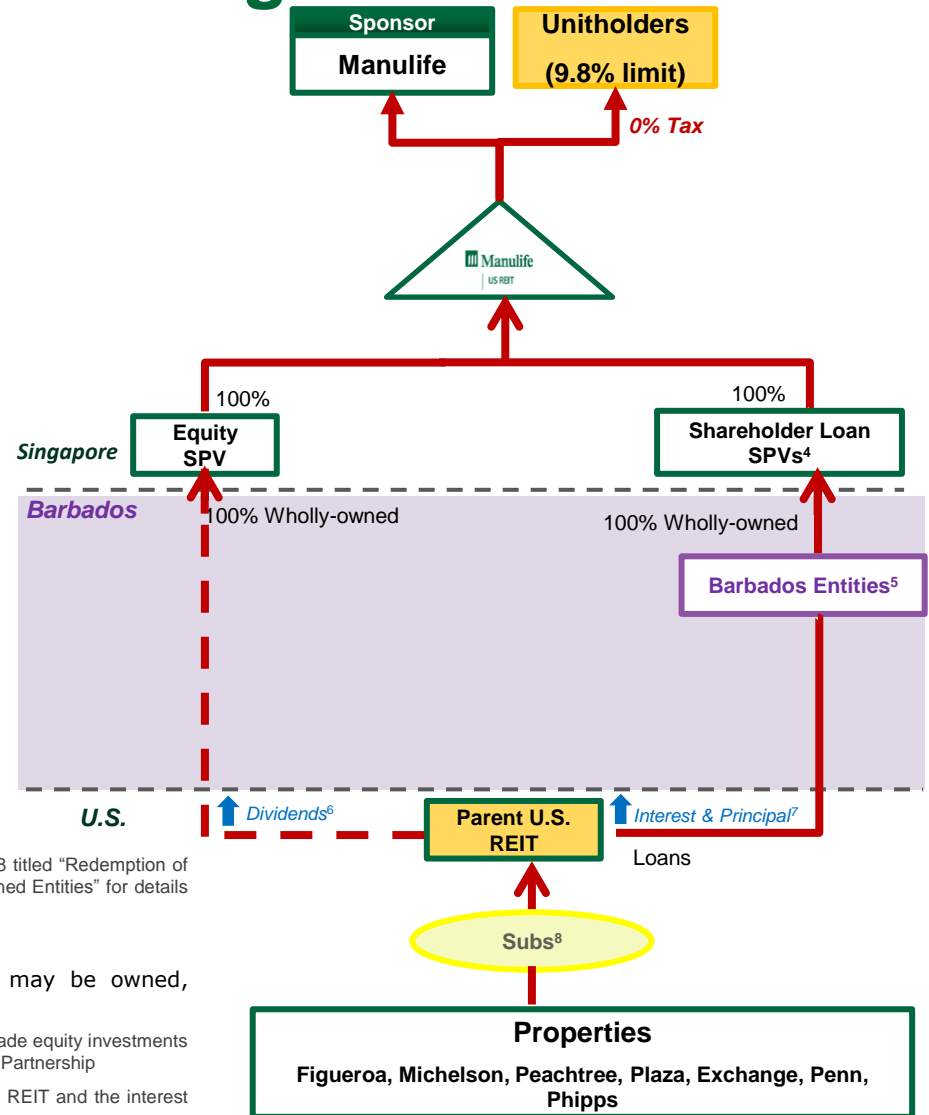
No 30%² withholding tax on interest and principal on shareholder's loan - **US Portfolio Interest Exemption Rule**

Zero tax in Singapore - **Foreign sourced income not subject to tax**

Distribution from US to Singapore through combination of dividends, and/or interest payments and principal repayments on shareholder loans

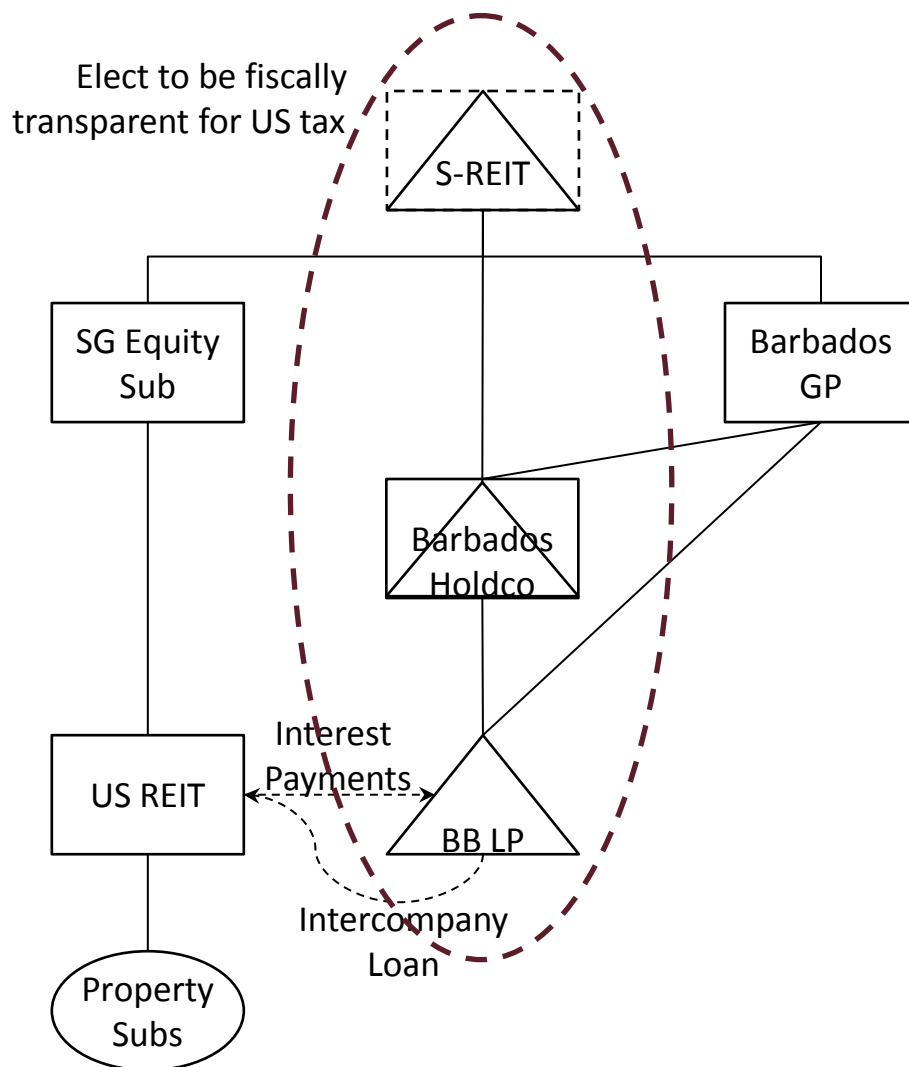
No single investor to hold more than 9.8% (including the sponsor) - 'Widely Held'³ rule for REITs in US

Manager will actively manage to minimise or pay no dividends from Parent U.S. REIT to Equity SPV



- (1) As at 1 Jan 2018. Please refer to the SGX announcement dated 2 Jan 2018 titled "Redemption of Preferred Shares by U.S. REITs and Proposed Establishment of Wholly-Owned Entities" for details of the restructuring undertaken by MUST
- (2) For U.S. and non U.S. persons filing valid tax forms
- (3) No more than 50% of the value all outstanding Units may be owned, directly or indirectly, by 5 or fewer individuals
- (4) There are three wholly-owned Shareholder Loan SPVs, each of which has made equity investments in two wholly-owned Barbados entities which had formed a Barbados Limited Partnership
- (5) The Barbados Limited Partnerships have extended loans to the Parent U.S. REIT and the interest income on the loans is taxed in Barbados
- (6) Subject to 30% withholding tax
- (7) Principal repayments are not subject to U.S. withholding taxes. Interest payments are not subject to U.S. withholding taxes assuming Unitholders qualify for portfolio interest exemption and provide appropriate tax certifications, including an appropriate IRS Form W-8
- (8) Each Sub holds an individual property

The Barbados Solution: Detail

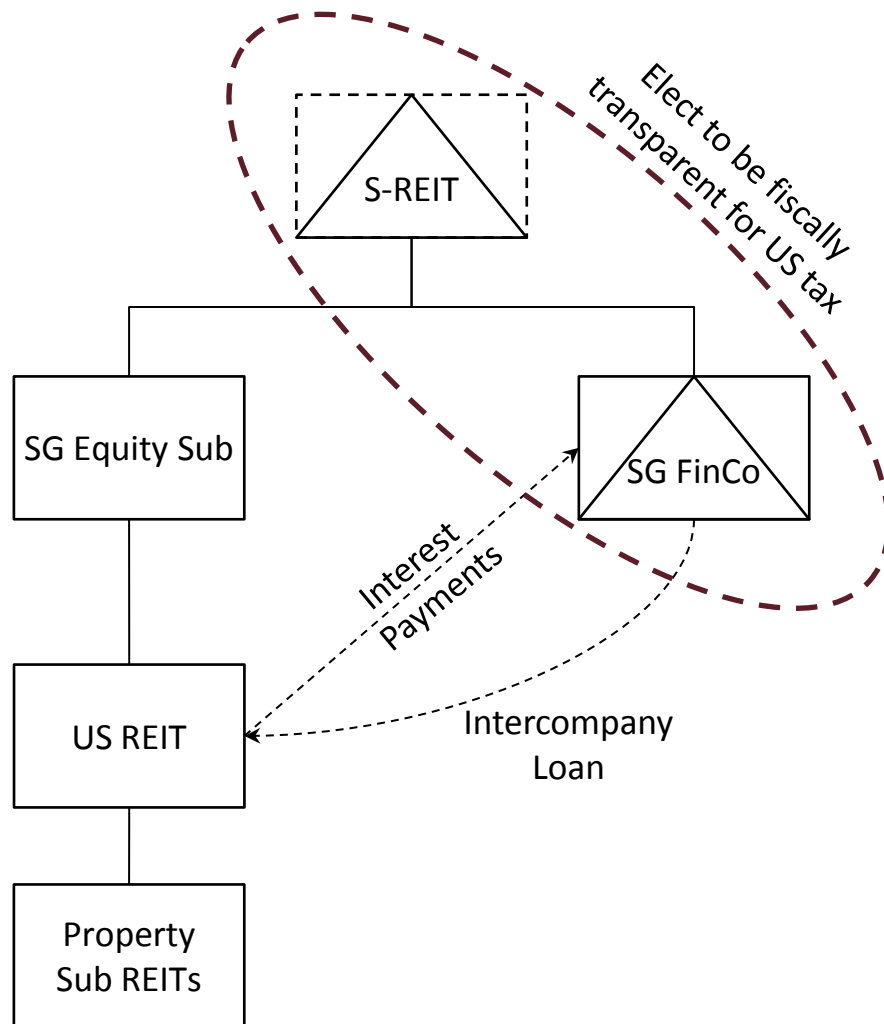


- Structure adopted by Manulife U.S. REIT and Keppel-KBS U.S. REIT
- Interest:
 - U.S. withholding: **Portfolio interest exemption**
 - Subject to taxation in Barbados (by Barbados GP and Barbados LP)
- 30% U.S. withholding tax on:
 - Dividends of earnings from U.S. REIT
 - Interest payments to the extent attributable (directly or indirectly) to Barbados GP (**small**)

2018 Proposed Regulations

- Proposed Section 163(j) regulations generally provide that if a REIT holds assets treated as real property under the REIT rules or shares in other REITs, it is eligible to be an electing real property trade or business
- Proposed Section 267A regulations narrow the Section 267A statutory regime and by their terms set forth “the exclusive circumstances in which a deduction is disallowed under Section 267A.” As such a deduction will be denied under Section 267A:
 - only for payments within structures or arrangements described in the regulations; and
 - only to the extent that a deduction/no income tax result would be achieved (absent Section 267A) as a result of hybridity
- The proposed regulations are still in proposed form
 - Final regulations could differ materially from the proposed regulations
 - Final regulations are not expected to be materially less taxpayer friendly

Opportunity: Back to the Future



- US REIT Income:
 - Not taxed if distributed
- Interest:
 - U.S. withholding: **Portfolio interest exemption**
 - Not subject to taxation in Singapore
- Dividends:
 - U.S. withholding on distributed earnings
 - Not subject to taxation in Singapore
- Original MUST and KORE structure